No. 85-727

In the Supreme Court of the United States

OCTOBER TERM, 1985

THE MISSOURI FARMERS ASSOCIATION, INC.,
Petitioner,

VS.

THE UNITED STATES OF AMERICA,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE EIGHTH CIRCUIT COURT OF APPEALS

BRIEF AMICUS CURIAE AND BRIEF IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

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MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE

The Livestock Marketing Association (hereinafter LMA) respectfully moves this Court, pursuant to Rule 36, for leave to file the accompanying brief *amicus curiae* in support of the petition for a writ of certiorari.

The *amicus* is a national trade association of businesses involved in the sale and marketing of livestock. The members of LMA have a vital interest in the issue raised in this case because its resolution will have a great impact in their everyday business decisions.

It is a well-established proposition that federal law governs questions involving the rights of the federal government arising under nationwide federal programs such as the Farmers Home Administration's farm loan programs. When there is no federal statute to determine issues aris-

ing under these federal programs, however, the courts must determine what the federal law is. Is it a judicially constructed uniform rule of law or is state law incorporated as the applicable federal law?

Prior to this court's decision in *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), seven circuits had ruled on this question. Five of the seven circuits favored a judicially constructed uniform rule of law and two (including the Eighth Circuit) incorporated state law as the applicable federal law. Relying on this court's guidance in *Kimbell*, a majority of the circuits now use incorporated state law as the applicable federal law to resolve issues arising under the federal loan programs. In the instant case, however, the Eighth Circuit - apparently relying on *Kimbell* - has seen fit to depart from its former position of using incorporated state law and has departed from the decisions of a majority of the other circuits.

Because of the apparent confusion regarding this Court's test for determining the source of federal law when there is no federal statute, *amicus* supports the petition for a writ of certiorari and seeks permission to submit its brief to assist the Court in considering the issues raised by this litigation.

Respectfully submitted,

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November, 1985

QUESTION PRESENTED

Whether the Eighth Circuit's refusal to incorporate state law as the applicable federal law governing Farmers Home Administration security interests conflicts with this Court's unanimous decision in *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), and resurrects and perpetuates the conflict among the circuits which *Kimbell* sought to resolve.

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BRIEF OF THE LIVESTOCK MARKETING ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITION FOR A WRIT OF CERTIORARI

INTEREST OF THE AMICUS

The interest of the *amicus* is detailed in the motion accompanying this brief.

STATEMENT OF THE CASE

The facts involved in this case were undisputed at the district court level and the court of appeals level.

In 1984 Edward and Barbara Stoops (the "Stoops") began borrowing money from the Farmers Home Administration (FmHA) and executed security agreements granting the FmHA an interest in farm equipment and crops. In 1979 and 1980 the Stoops defaulted on the notes to the FmHA. In 1980 as part of a liquidation plan the FmHA, in the person of both its State Director and its County Supervisor, expressly instructed the Stoops in writing to sell remaining crops and livestock, allowing the Stoops the discretion to decide when the market prices were best. Following the FmHA's directions, the Stoops sold crops to the Missouri Farmers Association, Inc. (MFA), and MFA promptly paid the Stoops for the crops.

In 1983 the FmHA brought this conversion action against MFA seeking to recover the value of the crops purchased by MFA, in effect asking that MFA pay a second time for the full value of the crops. The FmHA pled the case under the common law theory of conversion. Under the common law, conversion occurs if a person exercises dominion or control over property of another against the other person's wishes. MFA answered by arguing that FmHA did not have a security interest in the crops but that, even if it did have a security interest, the FmHA had authorized the sales of the crops under R.S.Mo. §400.9-306.

The district court in its initial decision applied Missouri law to decide the issue of whether the FmHA had a security interest in the crops purchased by MFA. *United States v. MFA, Inc.*, 580 F.Supp. 35, 36 (E.D. Mo. 1984). On the authorization issue, the district court also appeared to apply Missouri law in deciding that the FmHA had not "released" its lien. On rehearing the district court reconsidered its ruling on the authorization issue in light of

a March 1984 Missouri Court of Appeal decision on the authorization argument, but declined to follow that case.[1]

On appeal the Eighth Circuit Court of Appeals held initially, in a brief *per curiam* decision, that the record on appeal revealed no mistake of law or fact. 753 F.2d 714 (8th Cir. 1985). On rehearing the Eighth Circuit ruled that Missouri law would not be applied in this case because it would conflict with the federal interests present in the FmHA program. Rather than apply the Missouri law as set out in *Charterbank Butler* the court chose to apply internal FmHA administrative regulations which address the circumstances under which FmHA officials have the authority to release security interests.

SUMMARY OF THE ARGUMENT

The decision of the Eighth Circuit fails to apply correctly the test established by this Court in *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979) for determining the source of federal law when there is no governing federal statute. The Eighth Circuit completely ignored the first step of the *Kimbell* test, miscomprehended the essence of the second step, and summarily disposed of the third step without adequate justification or support for its stated position.

The decision of the Eighth Circuit is in direct conflict with the decisions of a majority of the circuits on the same issue, thereby evidencing confusion among the circuits

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1. *Charterbank Butler v. Central Cooperatives, Inc.*, 667 S.W.2d 463 (Mo. App. 1984). This Missouri case joined numerous cases from other states in holding that under §9-306(2) of the U.C.C. a secured party cannot prevail in a conversion action against a third party purchaser if the secured party authorized the sale of the collateral.

with respect to this Court's test for determining the proper source of federal law. Since *Kimbell* five circuits have decided cases in which the courts had to determine the source of federal law applicable to FmHA claims against commission merchants that have sold mortgaged farm products or buyers that have purchased farm products. Three circuits have incorporated state law as the applicable federal law and two circuits have declined to incorporate state law.

The decision of the Eighth Circuit would permit a federal agency to change established federal and state law by promulgating self-serving regulations. Under both common law and state statutory law[2] a secured party who authorizes sales of collateral cannot hold a purchaser of collateral liable for conversion, for the simple reason that there can be no conversion if the secured party consents to (authorizes) sale of the collateral.[3] There is no evidence that Congress intended for the FmHA to have the authority to write such "heads we win, tails you lose" regulations so as to defeat hundreds of years of common law as codified by the states in section 9-306(2) of the U.C.C. This Court in *Kimbell* found, to the contrary, that Congress did not intend for the FmHA to have special privileges in its loan programs.

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2. Section 9-306(2) of the Uniform Commercial Code, as adopted by 49 states, provides: Except where this Article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof *unless the disposition was authorized* by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor. (Emphasis added.)

3. Conversion occurs if a person exercises dominion and control over property of another against the other person's wishes. Clearly, if the person has consented to a sale of the property such sale is not against his wishes and there can be no conversion.

ARGUMENT

A.

The Decision By The Eighth Circuit Fails To Apply Correctly The Test Established By This Court In United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979) For Determining The Source Of Federal Law When There Is No Governing Federal Statute.

In *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979), this Court was asked to determine whether liens arising under federal loan programs take precedence over liens arising under state law absent a federal statute setting priorities. In resolving the question this Court concluded first, that federal law applied and second, that the source of that federal law (whether a judicially devised federal rule or incorporated state law) was to be found by weighing three factors: 1) the need for nationally uniform body of law; 2) whether application of state law would frustrate specific objectives of the federal program; and 3) the extent to which application of a federal rule would disrupt commercial relationships predicated on state law. After applying these factors to the facts in *Kimbell*, this Court incorporated state law as the appropriate federal rule of decision.

The Eighth Circuit, recognizing the absence of an applicable federal statute, apparently relied on *Kimbell* to formulate a federal rule of decision to resolve issues related to the release of an FmHA lien. In applying *Kimbell*, however, the Eighth Circuit failed to address the first step of the *Kimbell* test: it failed to determine whether there was a need for a nationally uniform body of law. If the Eighth Circuit had addressed this step of

the test it would have found adequate guidance in *Kimbell* itself, where this Court determined there is little need for a nationally uniform body of law in the FmHA lending programs. 440 U.S. at 719.

In its analysis, the Eighth Circuit vaulted to the second step in the test: whether application of state law would frustrate specific objectives of the federal program. Offering scant explanation, the Eighth Circuit merely stated that "adoption of state law in this case would conflict with the interests present in the FmHA loan program." 764 F.2d at 489.

The specific test announced in *Kimbell* was "whether application of state law would frustrate specific *objectives* of the federal program." 440 U.S. at 729 (emphasis added). The Supreme Court defined the FmHA's objectives as "assisting farmers . . . that cannot obtain funds from private lenders on reasonable terms." *Id.* at 736. The Eighth Circuit's decision contains no language to show that it considered the objective of the FmHA's loan program as defined by this Court. The court simply used the wrong measuring device to find that a conflict existed.

The federal interest with which the Eighth Circuit found a conflict (though unarticulated) is actually the FmHA's interest in recovering funds disbursed to farmers through loan programs. This issue has been faced by this Court before. In *Kimbell* the FmHA argued that "applying state law to these lending programs would undermine its ability to recover funds disbursed and therefore would conflict with program objectives." *Id.*, p. 733. However, this Court refused to grant the FmHA special protection when it stated:

> . . . had Congress intended the private commercial sector, rather than taxpayers in general, to bear the risks of default entailed by these public welfare programs, it would have established a priority scheme displacing state law." (*Id.*, p. 734.)

The Eighth Circuit's decision flies in the face of this Court's decision not to grant the FmHA special protections in recovering disbursed funds. In effect the Eighth Circuit has given the FmHA special protections not available to private lenders in the same circumstances. The FmHA is permitted to recover from third parties regardless of whether they consented to sales of collateral whereas private lenders would be foreclosed from pursuing the same parties under identical circumstances.

In disposing of the third step of the *Kimbell* test, the Eighth Circuit summarily decided that failure to incorporate state law would not disrupt commercial transactions in Missouri because a purchaser of farm products "can easily determine whether or not the goods are covered by an FmHA security interest and take appropriate steps to protect itself from liability." 764 F.2d at 490. This simply is not true. If, for example, a buyer is purchasing farm products from sellers who reside in several counties in Missouri the buyer would have to check in each county each time a seller sells merely to determine who has filed financing statements. Then, because financing statements do not necessarily contain the same description of the collateral as the security agreement itself, nor do they indicate whether a secured party has consented to sales of some of the collateral covered by the security agreement, the buyer would have to contact each secured party to determine whether the specific product being sold was covered and whether the secured party had consented to the sale or not. When a buyer such as MFA is buying from hundreds of sellers on any given day it becomes an impossible task to make all necessary inquiries.

The second problem with the Eighth Circuit's statement is that buyers simply may not be able to determine whether the farm products are mortgaged or not. If, for example, an elevator is purchasing grain from a person who has purchased the grain from someone else, the elevator would not know the identity of the original seller. And, even though the person selling the grain directly to the elevator had granted no security interest to anyone, the elevator would still be subject to the security interest created by the original seller.[4]

Even without the difficulties encountered as a subsequent purchaser, buyers and commission merchants are often simply not able, because of time constraints, to check for liens on all the farm products they buy or sell. This is especially true for livestock markets, livestock dealers and packers. Under the Packers and Stockyards Act, livestock markets, dealers and packers are required to pay for livestock by the close of the next business day following the date of the transaction. 7 U.S.C. §228(b). This makes it virtually impossible to make all of the inquiries necessary to determine the interest or non-interest of any third parties and still abide by federal statutory law.

Thus determining whether or not the goods are covered by a security interest is a difficult, time consuming process at best, without decisions such as the Eighth Circuit's which would allow a secured party to authorize the sale and then unilaterally rescind the authorization.

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4. *See* Coates, *Financing the Farmer*, 20 Prac. Law 45, Nov. 1974 at 49; Dugan, *Buyer - Secured Party Conflicts Under Section 9-307(1) of the Uniform Commercial Code*, 46 U. Colo. L. Rev. 333, 334 (1975); Dolan, *Section 9-307(2): The U.C.C.'s Obstacle to Agricultural Commerce in the Open Market*, 72 Nw. U. L. Rev. 706, 713 (1977).

B.

The Decision Of The Eighth Circuit Is In Direct Conflict With The Decisions Of Other Federal Courts On The Same Issue Thus Indicating An Inability Of The Circuits To Apply This Court's Test For Determining The Proper Source Of Federal Law.

This Court's decision in *Kimbell,* narrowly construed, established that state law should be adopted as the federal rule of decision in cases involving disputes as to the priority of consensual liens. However, the *Kimbell* test for determining the content of a federal rule of decision is applicable to a wide variety of cases where federal courts are faced with the task of formulating the federal law. The question of what law should be applied as the federal rule in such cases "depend[s] upon a variety of considerations always relevant to the nature of the specific governmental interests and to the effects upon them of applying state law." 440 U.S. at 728. This choice of law procedure was designed to guide federal courts through the steps necessary to make a proper determination of the applicable federal rule. Regrettably, the courts have demonstrated an inability to apply the *Kimbell* choice of law test to the specific facts and issues unique to farm products conversion cases. Consequently, different federal courts facing the same issue have reached a variety of conclusions.

A majority of the federal courts that have decided the source of federal law in FmHA mortgaged farm products conversion cases have adopted state law. *United States v. Friend's Stockyard, Inc.*, 600 F.2d 9 (4th Cir. 1979) (FmHA sued two livestock auctioneers who sold cattle for a farmer who had previously given the FmHA a security interest in those cattle. The Fourth Circuit

held that the law of the state in which the transaction occurred should be incorporated as the federal law.); *United States v. Public Auction Yard,* 637 F.2d 613 (9th Cir. 1980) (A Montana statute limiting the liability of livestock auction markets selling mortgaged livestock was adopted as the federal rule of decision.); *United States v. Southeast Mississippi Livestock Farmers Association,* 619 F.2d 435 (5th Cir. 1980) (Mississippi U.C.C. law was applied as the federal rule of decision to determine whether a description of collateral was sufficient to give notice of the FmHA's security interest.); (*See also United States v. Bailey Feed Mill, Inc.,* 592 F.Supp. 844 (E.D. N.C. 1984), where the district court incorporated a North Carolina statute limiting the duration of a security interest in crops to 18 months as the federal rule to determine the effectiveness of an FmHA claim against a feed mill which purchased soybeans from a farmer.) Thus the Eighth Circuit has placed itself in direct conflict with the decisions of these other circuits.

The Eighth Circuit is also in conflict with circuits having routinely adopted state law as the federal rule of decision to resolve legal issues typically settled by application of the U.C.C. *United States v. Meadors,* 753 F.2d 590 (7th Cir. 1985); *United States v. Rhine Main Associates,* No. 82-3136 slip op. (6th Cir. April 15, 1985); *United States v. Lattauzio,* 748 F.2d 559 (10th Cir. 1984). *See also, Johnson v. United States Department of Agriculture,* 734 F.2d 774 (11th Cir. 1984) (State law governing methods of foreclosure was adopted as the federal rule applicable to the FmHA).

In *United States v. Kennedy,* 738 F.2d 586 (3rd Cir. 1984), the Third Circuit flatly stated *Kimbell* is not controlling in farm products conversion cases, finding that it

applies only when there is no existing federal law. In this case the Third Circuit held that there was an existing common law rule of conversion as developed in the 1963 Third Circuit decision of *United States v. Sommerville,* 324 F.2d 712 (3rd Cir. 1963). In *Kennedy,* the pre-*Kimbell* common law rule was applied as the federal rule of decision. A district court judge in the Eastern District of Pennsylvania has taken the *Kennedy* decision one step further, holding that federal regulations control over state law. *United States v. New Holland Sales Stable, Inc.,* 603 F. Supp. 1379, 1383 (E.D. Pa. 1985). Citing *Kennedy,* the district judge rejected *Kimbell* as being inapplicable because of the existence of a federal regulation governing the release of FmHA liens. This judge ruled that the existence of a federal regulation (albeit a procedural regulation designed to guide FmHA officials) preempted any analysis of whether substantive state law should be incorporated as the federal rule of decision.

In direct conflict with the *New Holland* decision, a recent decision by a federal judge from the District of Kansas held that FmHA administrative regulations do not equate with a Congressional proclamation which, under *Kimbell,* would preclude adoption of state law. *United States v. Central Livestock Corporation,* No. 85-1065K slip op. (D. Kan. August 25, 1985). This decision relied on *Kimbell* to hold that state law would be applied as the federal rule of decision while rejecting the FmHA's argument that their internal regulations were "federal law" that could supersede state commercial law. The very argument adopted by the Missouri U.S. District Court and the Eighth Circuit was soundly rejected by the District Court in Kansas.

The agricultural marketing industry currently operates amidst confusion about what law to rely on to de-

termine exposure or potential liability for the purchase or sale of mortgaged farm products. Various federal courts have at different times applied as the federal rule of decision in mortgaged farm products conversion cases: 1) state law, 2) a pre-*Kimbell* common law rule of conversion liability, and 3) federal agency regulations. The inability of federal courts to apply this Court's *Kimbell* decision consistently has served to aggravate business tensions in the industry, especially in interstate commercial transactions. *Amicus* urges this Court to grant certiorari in this case and instruct federal courts how the *Kimbell* decision applies to farm products conversion cases.

C.

The Decision Of The Eighth Circuit Permits A Federal Agency To Nullify Established Common Law And State Statutory Codification Of The Common Law By Issuing Self-Serving Regulations.

Historically, the common law has recognized that there can be no tort of conversion if the injured party consented to the alleged conversion. This common law rule has been codified in the Uniform Commercial Code in §9-306 (2), which provides that there is no liability to a secured party if the secured party consented to (or "authorized") the sale of its collateral. A plaintiff cannot complain that he has been injured if he consented to the action that caused his injury.

This rule has uniformly been recognized by state courts and by many federal courts. See, *United States v. Lindsey*, 455 F.Supp. 449 (N.D. Tex. 1978), *United States v. Central Livestock Assn.*, 349 F.Supp. 1033 (D. N.D. 1972).

The FmHA has sought to nullify the consent (or "authorization") defense by promulgating regulations which would literally provide that authorization given by the FmHA is not available as a defense to the unfortunate businessperson who purchases farm products. 7 C.F.R. §§1962.17 and 1962.18. These regulations would provide first, that despite authorization, the lien of the FmHA continues in both the farm products and the proceeds after the sale, and second, that in any event authorization given by the FmHA is not binding on the government if it later turns out that the action in authorizing the sale of collateral was to the "detriment" of the government.

There is no evidence that Congress intended for the FmHA to have the authority to write such regulations. This Court in *Kimbell* found, to the contrary, that Congress did not intend for the FmHA to have special privileges. The regulations on this point written by the FmHA are beyond the scope of their authority, contrary to the *Kimbell* decision, and, in any event, unconscionable.

The problem caused by the Eighth Circuit decision in adopting these regulations as law can be best shown by describing a typical transaction. Farmer borrows money from the FmHA and gives the FmHA a security interest in all his livestock. The FmHA authorizes Farmer to sell 50% of his calves every year and to use the proceeds to pay certain expenses. Over a period of years Farmer does exactly what the FmHA told him to do. He sells calves every year to a local livestock market. Later Farmer defaults on his FmHA loan. The FmHA then sues the local livestock market for the value of all calves sold by Farmer to the market, even though the FmHA *had consented* to all the sales. Under the decision of the Eighth Circuit the fact that the FmHA authorized the sales would

be no defense; the livestock market would have to pay a second time for all the cattle sold.

In effect the Eighth Circuit decision creates new law. It allows the FmHA to avoid the universally recognized defense of consent. Presumably, under the Eighth Circuit's ruling, other federal agency lenders could also avoid the defense of consent in the Eighth Circuit by merely writing administrative regulations similar to those of the FmHA. This result clearly is contrary to the intent of this Court's decision in *Kimbell Foods,* as articulated in *United States v. S.K.A. Associates,* 600 F.2d 513, 516 (5th Cir. 1979):

> Yet it seems to us that Justice Marshall in his very detailed opinion for a unanimous Court in *Kimbell Foods* sought to carefully instruct Government agencies that in their commercial lending activities they are subject to "customary commercial practices" [citing *Kimbell* 440 U.S. at 735] and should fare no better, and no worse, than a private lender.

CONCLUSION

The Eighth Circuit's decision in the instant case conflicts with the holding of this court in *Kimbell* and is an example of the difficulties being experienced by the federal courts in applying *Kimbell* to farm products "conversion" cases.

With the continuing farm crisis - especially among FmHA farmer-borrowers - *amicus* believes the federal courts will experience ever growing numbers of farm products "conversion" cases where they are called upon to

determine the source of federal law.[5] Absent additional direction from this Court the agricultural marketing industry will continue to labor under the confusion and tension created by the inconsistent application of a variety of laws. *Amicus,* therefore, respectfully requests that the Court grant the petition for a writ of certiorari.

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5. According to statistics released by the Farmers Home Administration in 1983, the FmHA, at the end of fiscal year 1978, had claims valued at $766,663 pending in the U.S.D.A.'s office of General Counsel against buyers and commission merchants for converting the FmHA's interest in secured livestock. At the end of fiscal year 1982, there were claims valued at $6,581,968 pending. At the end of fiscal year 1978, the FmHA had no claims pending against buyers and commission merchants for converting the FmHA's interest in secured grain. At the end of fiscal year 1982, there were claims valued at $7,194,321 pending.